ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

SUMMARY OF THE PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM INVESTMENT COMMITTEE

HELD ON
Wednesday, November 3, 2010
2:30 p.m.

The Investment Committee (IC) of the Arizona State Retirement System (ASRS) met at 3300 N. Central Avenue, 14th Floor Conference Room, Phoenix, Arizona 85012. Mr. Tom Connelly, Chair of the IC, called the meeting to order at 2:33 p.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Tom Connelly, Chair
Mr. Chris Harris, Vice-chair
Mr. Larry Trachtenberg (via telephone)
Prof. Dennis Hoffman (arrived at 2:38 p.m.)

Absent: None

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the October 12, 2010 Public IC Meetings

Mr. Larry Trachtenberg requested that the last paragraph of item 3 be changed to, "Mr. Hoffman, Mr. Harris and Mr. Trachtenberg concurred with views offered by staff."

Mr. Trachtenberg additionally requested the omission of item 5, paragraph 6, as the sentence did not accurately capture the conversation.

Mr. Paul Matson requested correction of "(ISP)" to (IPS) in item 8.

Motion: Mr. Chris Harris moved the minutes of the October 12, 2010 Public IC meetings be adopted as amended. Mr. Trachtenberg seconded the motion.

By a vote of 3 in favor, 0 opposed, 0 abstention, and 1 excused, the motion was approved.

3. Presentation, Discussion, and Appropriate Action Regarding the ASRS 8% Long Term Investment Rate of Return Objective

Mr. Chris Harris began the conversation by asking the Committee to define what it understood as the definition "long term." Briefly discussed was the definition that Meketa and NEPC each considered as an appropriate answer to this question. Mr. Tom Connelly stated that defining long term was relevant to the framing of this subject.

Mr. Matson agreed that defining long term was relevant to the framework. Further stating, long term is multi-generational and in the pension space would quantify to a span of 20-30 years plus.

Consensus was reached and for the purpose of this subject, it was agreed that long term would translate to 20-30 years plus.

Mr. Matson briefly referred to the item memo providing a brief synopsis of the subject. Further, Mr. Matson stated that the Board would hear the Committee's recommendations for utilization in the valuation report. Mr. Matson indicated that the discussion of the 8% rate of return objective is a continuation of the conversation which was borne out at the September 2010, Board Strategic Session meeting. He also indicated that this Committee meeting will specifically focus on various economic factors, which join in determining the reasonable estimates for the expected long-term rate of return.

Mr. Matson introduced Mr. Steve McCourt, Meketa, to discuss the information Meketa provided for the meeting. Mr. McCourt reiterated the earlier definition of long term and stated that he too shared the philosophy. Further, Mr. McCourt stated that there are no informative models to mark how assets will move. Mr. McCourt presented three frameworks: Historical Analysis, GDP Allocation, and Building Blocks; the three frameworks of forecasting being the most commonly used.

Mr. McCourt stated that the U.S. is fortunate to have a very long experience in the stock and bond market, and to have a history of returns over a long period of time from which one may draw data. Mr. McCourt detailed the advantages and disadvantages of historical allocation returns. Citing for example, average rates, 1926-2009 listed on page 3 of Meketa's presentation with an average of 9.7% per year for U.S. Equities. An engaged conversation focused on the historical aspects of returns based upon global historical events, evolving economies of developing nations, behavioral aspects, and availability to data.

Mr. McCourt briefly discussed the GDP Allocation as a macro economic model and how GDP constructed to show how productivity is returned over a period of time and how these ultimately flow from GDP to the economy: Capital, Labor and Transfer Payments. Mr. McCourt expressed that the tricky part of that it is not easy to predict growth of income.

Mr. McCourt then spoke on the Building Blocks Model, indicating that this was the shorter-term model. The most notable advantage of this method is that it takes into account the current pricing and economic environment. The disadvantages being its sensitivity to assumptive changes and ignoring the dividend payout ratio and its impact on growth; future growth expectations, and explanations of payout. Mr. McCourt concluded this portion of his discussion of Exhibit A stating that, there are no perfect models to provide an answer and the three models presented were simply to frame the discussion.

Mr. Connelly asked Mr. McCourt if he was "okay" with the 8% assumption. Mr. McCourt affirmed that yes, he was okay with the 8% assumption. Mr. McCourt concluded his presentation of Exhibit A, and did not intend to speak to Exhibit B, as it was previously provided as Board meeting material. It was included as a refresher.

Mr. Christopher Levell, NEPC, LLC, participated via telephone conference call, and stated that the NEPC material was the same material as presented to the full Board on September 3, 2010, therefore he would just hit the high points.

Mr. Levell indicated that 8% was an important decision and an important assumption that would have to bear both the good and the bad. Mr. Levell reviewed the NEPC presentation and addressed questions and comments from the Committee. When asked NEPC's opinion on the 8% rate, Mr. Levell indicated that NEPC was comfortable with it, and will support the current decision. Upon Mr. Levell's conclusion, Mr. Harris asked Mr. Allan Martin, NEPC, his opinion on the 8% rate, to which Mr. Martin stated that the "8% is defensible" and affirmed its reasonableness.

Upon the conclusion of NEPC's presentation, Mr. Gary Dokes introduced Mr. Dave Underwood of the ASRS. Mr. Underwood indicated that the IMD approached this subject from various approaches, and that the IMD presentation was an amalgam of Meketa's three types of allocation strategies. Mr. Underwood stated that based on his research the defense of the 8% is very strong.

Mr. Underwood's presentation outlined various scenarios of probable outcomes. Additionally, this presentation gave rise to discussion pertaining to salary inflation, aggregate payroll, effects on the plan caused by Return to Work, and if the actuary uses arithmetic and geometric growth calculations. Mr. Harris asked for clarification on what IMD saw as long term as presented on Page 7 of the presentation; Mr. Underwood too affirmed that if was 25 to 30 years plus.

At the conclusion of Mr. Underwood's presentation, Mr. Connelly asked others their thoughts. Mr. Trachtenberg agreed that though it is difficult to tell what the future will bring the ASRS should remain at 8% and based upon the information presented saw no reason to make any change. Professor Hoffman too stated that this has been an extremely helpful discussion, and that to focus on the long term was most appropriate

Mr. Dokes stated that he was very pleased at the tone of the meeting, and on the Committee's consensus on the definition of long term being 20-30 years plus; Mr. Dokes further stated that in his opinion, 8% is within the relevant range of probable long term expected rate of return outcomes.

Mr. Matson concluded the discussion by reiterating the points presented in the agenda item memo:

1. The ASRS has a multi-generational time frame that incorporates both the current economic environment (non-normal) as well as future economic environments.
2. The ASRS has salary inflation assumptions that are possibly higher than near term expectations. This inflation expectation is likely correlated with, and would therefore likely result in an offset to, ex-post differences in actuarial interest rate assumptions.
3. Ex-post differences from actuarial interest rates are captured annually in return experience differentials and are already incorporated into contribution rates on a smoothed ten-year basis.

4. A change in ex-ante actuarial interest rates could be incorporated immediately or allocated over time. If allocated over time the result would be similar to the return experience differential smoothing described above.
5. Maintaining the current actuarial interest still allows for future reviews and possible modifications of the actuarial interest rate.
6. The long-term trajectory of contribution rates would suggest that inter-generational equity in cost-sharing (paying of contribution rates) is perhaps best supported by considering contribution rate increases once contribution rates have begun their reversion to normal cost (a lower rate).

Motion: Mr. Christopher Harris moved to "Maintain the current actuarial interest rate of 8% and continue to review for long-term reasonableness in subsequent years." Mr. Larry Trachtenberg seconded the motion.

By a vote of 4 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

4. Call to the Public

No members of the public requested to speak; the meeting adjourned at 4:23 p.m.

Respectfully submitted,

Regina Landeros-Thomas, Secretary Date

Gary R. Dokes, Chief Investment Officer Date